

[Home for this Area](#)[Previous Location](#)

## TechNotes # 1

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# SBIC TechNotes

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### Technology transfer and seed capital investments

The Investment Division recently addressed the question of whether a particular structure of seed capital investment involving technology transfer was permissible under SBIC regulations. Since other SBICs may be contemplating similar transactions, we thought it useful to disseminate the position that we took in this instance. Once we have gained sufficient experience with the various relevant factors from actual practice, we expect to modify our Regulations to cover such transactions more explicitly.

In this particular case, a promising technology was identified at a university research foundation, and the SBIC agreed to sponsor additional research on it in exchange for an option to obtain an exclusive, worldwide license to commercialize the results. A shell corporation was formed by the SBIC to receive the SBIC's investment, to contract for the research from the university research foundation in exchange for the option, and implement the commercialization if the research proves to be successful.

As you probably recognize, the ownership aspect of the transaction raises significant issues under the Program's fundamental concept that SBICs are not intended to operate business enterprises or to function as holding companies exercising control over such enterprises. The transaction also raises a second issue as to whether the concern which was formed for the project is a passive business. At the same time, a project such as this clearly contributes to achieving the Program's overall public policy objective "to improve and stimulate the national economy" in that, if successful, it will result in the creation of a viable small business, with its increased employment and tax revenues, and in the application of technology to benefit the Nation's economy.

We concluded in this case that the SBIC was not violating Sec. 102 of the Small Business Investment Act or §107.865(a) of the Regulations when it was the organizer and sole owner of a company under the following conditions:

1. The concern is a seed-stage operation formed to develop, whether internally or through third-party contracts, and then exploit, some form of intellectual property.
2. At such time as the intellectual property is sufficiently developed, the SBIC reasonably expects the concern to be actively engaged in business, whether by manufacturing a product that will be distributed by others, by distributing a product manufactured by others, or by actively seeking out new licenses for applications of the intellectual property in question.

In the case discussed above, there was no Associate or Affiliate relationship between the SBIC and the university research foundation. We would not look favorably upon an SBIC funding research for an affiliated university, foundation or other entity.

This is a complex area in which we are attempting to accommodate transactions which legitimately serve the public policy objectives of the Program without opening the Program to abuses. If you are contemplating a future investment transaction of this type, you should discuss it first with your Investment Division analyst to ensure that we agree with your interpretation.

*The information provided in this SBIC Tech Note is the Investment Division's effort to summarize SBA's resolution of a recent SBIC matter. The information provided expresses the Division's resolution of this particular matter only. Any different facts or conditions might result in a different conclusion by the Division.*

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